



August 31, 2006

VIA FACSIMILE and EMAIL

The Honorable Larry E. Craig
United States Senate
520 Hart Senate Office Building
Washington, DC 20510

RE: S. 2821 *Withholding Tax Relief Act of 2006*

Dear Senator Craig:

I am writing to express support for your legislation, S. 2821, the *Withholding Tax Relief Act of 2006* (S. 2821). This legislation will repeal section 511 of the Tax Increase Prevention and Reconciliation Act of 2005 (P.L. 109-222) (TIPRA). The withholding provision in TIPRA is a broad new requirement mandating that federal, state and local governments withhold 3 percent from payments made for goods and services. Small business groups have expressed a high level of interest in S. 2821 to the Office of Advocacy (Advocacy). Advocacy takes its direction from small business groups which is why we are writing this letter of support.

Congress established Advocacy under Pub. L. 94-305 to represent the views of small businesses before Federal agencies and Congress. Advocacy is an independent office within the U.S. Small Business Administration (SBA), so the views expressed in this letter do not necessarily reflect the views of the SBA or the Administration.

Section 511 of TIPRA presents significant challenges for small entities and state and local governments. American small businesses operate in an environment which challenges them to be competitive and remain profitable. The withholding provision will impede the cash-flow of small entities, presenting another obstacle to their success. Section 511 of TIPRA amounts to a tax penalty on government contractors without a clear path for reimbursement. The amount of the penalty is variable; for instance if a contract generates a small profit or no profit the additional withholding presents serious cash management challenges. Additionally, the

withholding provision inhibits the efficient use of capital because it will limit funds that can be used to reinvest in the business.

In fiscal year 2005, the Federal government spent over \$300 billion purchasing goods and services from businesses. Purchases from small businesses represented almost \$80 billion. Two-thirds of the Federal government procurement falls under the Department of Defense (DOD). The Government Accountability Office (GAO) issued a report entitled “DOD Payments to Small Businesses” (GAO-006-358, May 2006). GAO concluded that disruptions in cash flow caused by contracting with DOD can significantly affect the day-to-day operations of small businesses. Adding a 3 percent tax withholding requirement will only exacerbate the cash flow issues already experienced by small entities seeking to do business with the government.

In addition to the burdens that may be imposed on small businesses by the withholding provision, section 511 of TIPRA may have unintended administrative costs on all levels of government required to collect the tax. The withholding requirement at a minimum will require changes to be made to the accounting methods and software used by governmental jurisdictions. That may be why the Congressional Budget Office described the withholding provision as an unfunded intergovernmental mandate.

Repealing section 511 of TIPRA will help small businesses maintain their ability to provide goods and services to governments at all levels. Thank you for your efforts on behalf of small businesses. Advocacy looks forward to working with you and Congress to repeal this provision.

Sincerely,

/s/ _____
Thomas M. Sullivan
Chief Counsel for Advocacy